Nos. 22,397 through 22,398-A

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant

v.

CALIFORNIA PORTLAND CEMENT CO.,

Appellee

CALIFORNIA PORTLAND CEMENT CO.,

Cross-Appellant

v.

UNITED STATES OF AMERICA,

Cross-Appellee

ON APPEALS FROM THE JUDGMENTS OF THE UNITED STATES
DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

REPLY BRIEF FOR THE UNITED STATES AS APPELLANT AND ANSWERING BRIEF FOR THE UNITED STATES AS CROSS-APPELLEE

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
GRANT W. WIPRUD,
ROBERT LIVINGSTON,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

Of Counsel:

WM. MATTHEW BYRNE, JR.,
United States Attorney.

LOYAL E. KEIR,
Assistant United States Attorney.

FILED

MAY 14 1968

WM. B. LUCK, CLERK

Nos. 22,397 through 22,398-A

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant

v.

CALIFORNIA PORTLAND CEMENT CO.,

Appellee

CALIFORNIA PORTLAND CEMENT CO.,

Cross-Appellant

v.

UNITED STATES OF AMERICA,

Cross-Appellee

ON APPEALS FROM THE JUDGMENTS OF THE UNITED STATES
DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

REPLY BRIEF FOR THE UNITED STATES AS APPELLANT AND
ANSWERING BRIEF FOR THE UNITED STATES AS CROSS-APPELLEE

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
GRANT W. WIPRUD,
ROBERT LIVINGSTON,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

Of Counsel:

WM. MATTHEW BYRNE, JR.,
United States Attorney.

LOYAL E. KEIR,
Assistant United States Attorney.

INDEX

Page

Cases:

Page

Cases (continued):

Miscellaneous:

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Nos. 22,397 and 22,398

UNITED STATES OF AMERICA,

Appellant

v.

CALIFORNIA PORTLAND CEMENT CO.,

Appellee

Nos. 22,397-A and 22,398-A

CALIFORNIA PORTLAND CEMENT CO.,

Cross-Appellant

v.

UNITED STATES OF AMERICA,

Cross-Appellee

ON APPEALS FROM THE JUDGMENTS OF THE UNITED STATES
DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

REPLY BRIEF FOR THE UNITED STATES AS APPELLANT AND ANSWERING BRIEF FOR THE UNITED STATES AS CROSS-APPELLEE [1]

1/ In accordance with the stipulation filed in this Court on January 18, 1968, the Government filed its opening brief as appellant on or about March 20, 1968; the taxpayer then filed an opening consolidated brief as appellee in the Government's appeals and as cross-appellant in its cross-appeals; and the instant consolidated brief is the Government's reply brief in its own appeals and answering brief in the taxpayer's cross-appeals.

OPINION BELOW

The findings of fact and conclusions of law of the District Court (Nos. 22,397 and 22,397-A, I-R. 119-130; Nos. 22,398 and 22,398-A, I-R. 176-191) are not officially reported.

JURISDICTION

The jurisdictional statement in the Government's opening brief as appellant (pp. 1-3) sets forth all of the jurisdictional facts material to the Government's appeals and, in large part, to the taxpayer's cross-appeals. As taxpayer notes in the jurisdictional statement in its opening consolidated brief (p. 2), the judgments of the District Court became final on July 31, 1967, and taxpayer's notices of appeal were filed on October 6, 1967. (Nos. 22,397 and 22,397-A, I-R. 162, 165; Nos. 22,398 and 22,398-A, I-R. 237, 240.) Taxpayer invokes the jurisdiction of this Court under 28 U.S.C., Section 1291.[2/]

QUESTIONS PRESENTED

The questions presented in the Government's appeals, as set forth in its opening brief (pp. 3-4), are whether the District Court has erroneously interpreted and applied the proportionate profits method in the following respects:

1. In allocating to mining costs the expenses of handling and storing purchased or fully depleted mineral materials (additives) prior to their addition to the kiln feed.

2/ It would appear that the taxpayer's notices of appeal may have been untimely. 28 U.S.C., Section 2107.

2. In excluding from the computation the income from sales of bagged cement, the costs producing such sales, and certain selling expenses.

3. In failing to include in the computation the costs of bags and bagging and the selling expenses as non-mining costs in their entirety.

4. In allocating between mining and non-mining income an inflated gross income figure based on list prices, instead of allocating the actual receipts produced by the so-called discount prices.

The additional questions taxpayer seeks to present on its cross-appeals are:

1. Whether the Government is collaterally estopped from raising the above questions on appeal, by reason of a stipulated District Court judgment as to earlier taxable years of the taxpayer; and

2. Whether if the instant decision of the District Court is not affirmed, taxpayer's loading costs should be treated in accordance with taxpayer's alternative contention below.

STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes and other authorities involved are set forth in Appendix A to the Government's opening brief.

STATEMENT

The material facts, as found by the District Court (Nos. 22,397 and 22,397-A, I-R. 120-127; Nos. 22,398 and 22,398-A, I-R. 176-187), are set forth in the Government's opening brief (pp. 4-10). Insofar as the statement in taxpayer's opening brief is devoted to the findings (pp. 2-3), it is in accord with the Government's statement. Insofar as the taxpayer's statement is devoted to the history and import of prior litigation (pp. 3-5), argumentative matters are involved and accordingly will be dealt with below.

SUMMARY OF ARGUMENT

The merits of the issues raised on the Government's appeals have already been summarized in its opening brief, and no purpose would be served by reiterating that summary here.

The taxpayer's primary contention, on its cross-appeals, is that the Government is foreclosed from a hearing on the merits by the doctrine of collateral estoppel. That contention, rejected by the District Court, was not preserved by the taxpayer's notices of appeal which, in any event, may well have been untimely. Assuming that the contention is properly before this Court, it is patently without merit. Taxpayer invokes the doctrine by reference to litigation involving its earlier taxable years -- more particularly, to District Court rulings entered in 1962 which were (with one exception re-entered in 1965 by stipulation of the parties in order

to conclude the litigation and avoid a third trial. The doctrine does not apply, in the light of the Supreme Court's decision in Commissioner v. Sunnen, 333 U.S. 591, because: (1) The facts were different; (2) the stipulated decision concluding the earlier litigation reserved the Government's right to relitigate the issues; and (3) there have been material intervening changes in the law and legal climate.

The taxpayer's second contention on its cross-appeals is that, if the decision below is not affirmed, this Court should consider its "alternative computation", which was rejected by the District Court. That computation was untimely, being offered by taxpayer some two years after the complaints herein were filed and seeking entirely different relief. Moreover, it is unsupported by any appellate authority or any other final court decision and is contrary to the basic premises and logic of the proportionate profits method.

ARGUMENT

I

THE GOVERNMENT IS NOT BARRED FROM A HEARING ON THE MERITS OF ITS APPEALS BY THE DOCTRINE OF COLLATERAL ESTOPPEL

Taxpayer's primary contention in its opening brief (pp. 8-24) is that the Government is barred from a hearing on the merits of its appeals, under the doctrine of collateral estoppel, by reason of the stipulated findings of fact, conclusions of law and judgment entered on February 16, 1965, in California Portland Cement Co. v. Riddell (S.D. Calif., Central Div., No. 138-58-WM) (18 A.F.T.R. 2d 5424).

The District Court rejected that contention. (Nos. 22,397 and 22,397-A, I-R. 129; Nos. 22,398 and 22,398-A, I-R. 189-190.)[3/] Taxpayer failed to assign the ruling as error in its notices of appeal (Nos. 22,397 and 22,397-A, I-R. 165; Nos. 22,398 and 22,398-A, I-R. 240) which were filed, as noted above, more than sixty days after the District Court's judgments became final. However, the Government does not seek to avoid the issue and assumes hereinafter that it is properly raised.

3/ In its opening brief taxpayer not only ignores the District Court's rejection of its collateral estoppel contention, but asserts (Br. 5, 25 *et seq.*) that the District Court relied upon and followed the very decision on which taxpayer's collateral estoppel argument was and is based. There is nothing in the record to support this assertion; to the contrary, the record shows that the trial judge decided the case on the basis of his own interpretation of certain statutory language. (Nos. 22,397 and 22,397-A, I-R. 117-118; Nos. 22,398 and 22,398-A, I-R. 170-171.)

The cornerstone case on collateral estoppel in tax litigation is, of course, Commissioner v. Sunnen, 333 U.S. 591. Noting therein that the doctrine of collateral estoppel has a much narrower scope than res judicata, the Supreme Court expressed concern lest the doctrine be misapplied to give taxpayers "vested rights" in "obsolete or erroneous" judicial determinations, with resulting "discriminatory distinctions in tax liability, and * * * litigious confusion". (333 U.S., p. 599.) The Court was accordingly at pains to limit the operation of collateral estoppel in tax litigation quite strictly. It envisioned a variety of subtle changes in law, any one of which would lift the bar of estoppel, as where (p. 600) "a judicial declaration intervening between the two proceedings may so change the legal atmosphere as to render the rule of collateral estoppel inapplicable", or where there is "a modification or growth in legal principles as enunciated in intervening decisions of this Court". And the Court cautioned (p. 600) against "neglecting legal modulations by this Court", and against "blind reliance upon the rule of collateral estoppel".

While the examples of intervening decisions given in Sunnen are in terms of the Court's own decisions or decisions of state courts of last resort, Sunnen neither holds nor intimates that these are the only tribunals whose decisions may sufficiently affect the law or legal climate to lift the bar of estoppel. In McCall v. Commissioner, 312 F. 2d 699 (C.A. 4th), the court held that one of

its own prior decisions, together with a decision of the Supreme Court, effected a sufficient "shift in emphasis, if not in basic law, by the Supreme Court and this Court respectively", to lift the bar of estoppel and permit "the important consideration of equality of tax treatment" to prevail. (312 F.,2d p. 706.) More recently, in CBN Corp. v. United States, 364 F. 2d 393, certiorari denied, 386 U.S. 981, the Court of Claims relied upon its own intervening decisions as effecting the necessary change in law or legal climate.

Without regard to changes in the law, the bar of collateral estoppel is averted, of course, if the facts in the later case differ from those involved in the earlier litigation. In this respect, the Supreme Court held in Sunnen that even the most technical factual differences suffice, saying in part (333 U.S., p. 601):

> But if the relevant facts in the two cases are separable, even though they be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case. Thus the second proceeding may involve an instrument or transaction identical with, but in a form separable from, the one dealt with in the first proceeding. In that situation, a court is free in the second proceeding to make an independent examination of the legal matters at issue.

In this connection the Court cited Campana Corp. v. Harrison, 135 F. 2d 334 (C.A. 7th). The court held in that case that the taxpayer had failed to show that the facts before it were precisely the same as those presented in earlier litigation involving earlier taxable years. In so holding, the court stressed

inter alia that (p. 336): "Whether the conditions remain the same as in the former case, no one knows".

In the case at bar it is simply not true, in the first instance, that the facts involved are in all material respects the facts which were presented in the litigation involving taxpayer's earlier years. The two cases differ factually in the following respects, among others:

1. The instant case involves taxpayer's mining and manufacturing operations at two sites, Colton and Mojave. But taxpayer did not begin its operations at Mojave until 1956, and the facts relating to such operations were therefore not involved in the earlier litigation covering the taxable years 1951 and 1952. In this respect, to repeat the above-quoted language from Sunnen, "the relevant facts in the two cases are separable, even though they be similar or identical * * *."

2. Taxpayer concedes (Br. 15-16) that the issue as to handling additives was expressly reserved, without prejudice, in the stipulated decision concluding the earlier litigation. And the District Court did not find (as it did with respect to some issues) that the facts and circumstances relevant to handling additives were the same in both cases. (Nos. 22,398 and 22,398-A, I-R. 185-186.)

3. The evidence of record in the two cases bearing on the discount issue is not the same. To the contrary, as detailed in our

opening brief (pp. 39-42), the instant record shows that -- whatever the nature of the discount may have been in earlier years -- it was a trade discount during the taxable years here involved, reflecting the competitive selling price actually obtained by all major cement producers in taxpayer's market area.[4/]

In short, the two cases do not present a common and identical factual context, as required by the doctrine of collateral estoppel. Moreover, it should be noted (before turning to substantial intervening changes in the law) that the history and terms of the stipulated decision would, without more, preclude its use as a basis for collateral estoppel. As detailed in taxpayer's brief (pp. 9-12), the earlier litigation had a long and tortuous history involving two trials and two reversals by this Court. And taxpayer is quite correct insofar as it states that (p. 12), on the second remand, the Government wished to avoid a third trial by stipulating the decision. It would also appear from the colloquy quoted in taxpayer's brief (pp. 12-13, fn. 40) that taxpayer's counsel wanted a decision which would preclude relitigation of all issues except

---

4/ In view of this evidence, we submit that it was clear error for the District Court to find (Nos. 22,398 and 22,398-A, I-R. 185-186) that the facts and circumstances relevant to taxpayer's discount practices during the years here involved were in substance identical with the facts and circumstances pertaining to such practices during the earlier taxable years.

the additives issue. On the other hand, taxpayer quotes (Br. 14, fn. 45), with commendable candor, the following statement by Government counsel:

> And although now it doesn't seem, as a matter of law, that we have to be too concerned, nevertheless I wouldn't want it as a matter of record that I have stipulated and that the Government would be so bound. If the collateral estoppel principle is against us, it will be as a matter of law rather than by my agreement.

Whatever the desires and intentions of the respective parties, however, they must yield to the clear and unambiguous provision in the stipulation,as ultimately framed and executed, that (18 A.F.T.R. 2d, p. 5425):

> By agreeing to the entry of the foregoing Findings of Fact and the following Conclusions of Law the defendant has not waived his objection thereto nor does the defendant concede the correctness thereof either for the taxable years in suit or subsequent taxable years. Defendant has stipulated to the entry thereof to avoid another trial for the taxable years involved and so that final Findings of Fact and Conclusions of Law and a final Judgment may be entered without further delay.

We submit that this unqualified language reserved to the Government the right to relitigate the issues with taxpayer for

subsequent taxable years, with or without identity of facts.[5/]

But the Government's right to relitigate issues involved in the earlier litigation does not rest solely upon the stipulated reservation of that right, or upon factual differences. Wholly apart from those considerations, the doctrine of collateral estoppel is inapplicable here by reason of intervening changes in the law.

The pertinent changes are those occurring after October 8, 1962. On that date the second trial in the earlier litigation concluded in the District Court's entry of comprehensive findings of fact and conclusions of law in California Portland Cement Co. v. Riddell (17 A.F.T.R. 2d 782). The District Court ruled *inter alia* that: (1) Both the income from sales of cement in sacks and the costs producing such sales should be excluded from the proportionate profits computation; and (2) taxpayer's depletable mining income should not be reduced by the amount of its "cash discounts", the costs of loading cement in bulk for shipment to customers, or the costs of purchasing, mining and processing additives. The sole issue on the Government's second appeal was whether the costs of purchasing and mining additives were properly

---

5/ Taxpayer is incorrect in its assertion (Br. 8, fn. 20) that the Government prosecuted an appeal from the stipulated decision, and that the appeal was "dismissed". An appeal was never intended, authorized or docketed. A notice of appeal, inadvertently filed, was withdrawn as soon as the error was discovered.

treated by the District Court as includible in taxpayer's mining costs, for the purposes of the proportionate profits computation. This Court reversed on that issue and remanded the case for further proceedings (330 F. 2d 16).

In order to avoid a third trial and bring the seven-year-old litigation to a close, as noted above, a stipulated decision was entered, with a reservation of the Government's right to relitigate, on February 16, 1965. As taxpayer states (Br. 15), and as appears on the face of the stipulation (18 A.F.T.R. 2d 5424), the agreed findings of fact and conclusions of law were those entered on October 8, 1962, with only minor modifications apart from the change required by this Court's reversal on the additives issue. In other words, the application of the proportionate profits method to which the Government agreed in 1965, to avoid a third trial, substantially reflected the law as interpreted by the District Court in its findings and conclusions of October 8, 1962. Quite obviously, then, the question is what changes in the law have occurred since 1962. To determine this it is necessary, at the outset, to review the state of the law in 1962.

In the late 1950's and early 1960's, controversies in the courts over the depletion allowances of integrated miner-manufacturers were focused upon their mining cutoff point -- not upon the detailed application of the proportionate profits method. For a time,

integrated producers of cement and vitrified products successfully contended in various appellate courts that their depletable mining income was their gross income from sales of their finished manufactured products. See, e.g., Dragon Cement Co. v. United States, 244 F. 2d 513 (C.A. 1st, 1957), certiorari denied, 355 U.S. 833, and cases therein cited; the Seventh Circuit's decision in Cannelton Sewer Pipe Co. v. United States, 268 F. 2d 334 (1959); and this Court's first two decisions in the Monolith Portland Cement Co. litigation (Monolith Portland Cement Co. v. United States, 269 F. 2d 629 (1959), and Riddell v. Monolith Portland Cement Co., 301 F. 2d 488 (1962)).

In 1960, however, the Supreme Court reversed the Seventh Circuit's decision in Cannelton, holding (as more fully set forth in the Government's opening brief (pp. 16-17)) that the depletable mining income of an integrated producer of sewer pipe and other vitrified products was its constructive income from its raw minerals, at the point where those minerals were ready for industrial use and consumption. The full sweep of this decision was not immediately apparent. Thus, in its second Monolith decision, entered on March 23, 1962 (301 F. 2d 488), this Court reaffirmed the taxpayer's right to depletion on sales of finished cement, viewing Cannelton as distinguishable in that: (1) It involved different minerals; and (2) there was a commercial market for those minerals, but not for Monolith's limestone. But on January 14, 1963, in Riddell v. Monolith Cement Co., 371 U.S. 537, the Supreme Court

summarily reversed, holding that Cannelton was controlling and that Monolith's depletion base was its constructive income from crushed limestone.[6/]

Meantime, the courts had given scant attention, or none, to the proportionate profits method and just how it should be applied. The matter was not of great importance, of course, so long as an integrated producer was authorized by the courts to take depletion on the sales of his manufactured product. There were few computational issues to be raised, and these were of relatively minor importance. For example, on the first Monolith appeal in 1959, the Government's sole assignment of error was that the District Court should have excluded from the taxpayer's depletion base the portion of its gross income attributable to additives -- a view which this Court rejected.

The situation began to change in 1960 with the Cannelton decision. But the scope of Cannelton remained uncertain until the Supreme Court's 1963 decision in Monolith -- and indeed has continued to be litigated by integrated producers seeking depletion on their finished product. See, e.g., United States v. Portland Cement Co. of Utah, 315 F. 2d 169 (C.A. 10th); United States v. Longhorn

---

6/ Monolith did not elect the pre-kiln cut-off point made available retroactively to integrated cement manufacturers by the 1960 legislation discussed on pp. 17-18 of the Government's opening brief.

Portland Cement Co., 328 F. 2d 491 (C.A. 5th); United States v. Light Aggregates, Inc., 343 F. 2d 429 (C.A. 8th); Solite Corp. v. United States, 375 F. 2d 684 (C.A. 4th), certiorari denied, 389 U.S. 841. In short, the scope and impact of Cannelton were still much in doubt in 1962, particularly with respect to integrated cement producers.

Nor did the election by cement producers of the pre-kiln cutoff point, under the 1960 legislation, immediately generate detailed judicial consideration of the proportionate profits method in its new context. Indeed, the District Court decision of October 8, 1962, in favor of the instant taxpayer -- our initial point of reference with respect to changes in the law -- was one of the first decisions by any court to deal with the problems of relating the proportionate profits method to the pre-kiln cutoff point. At the end of 1962, none of the appellate courts had considered these problems with respect to electing cement producers, nor had the Court of Claims.

It was not until March 13, 1964, that the Court of Claims entered its decision in Standard Lime and Cement Co. v. United States, 329 F. 2d 939. That decision, later cited with approval by appellate courts, gave extended consideration both to the nature of the proportionate profits method and to its application by reference to the pre-kiln cutoff point of an integrated cement producer.

Generally, the Court of Claims held that: (1) The proportionate profits method is centered on the premise that each dollar of the costs expended to produce and sell the manufactured end product earns the same percentage of the income; (2) costs are allocable to mining only to the extent incurred for the benefit of the mining phase of the producer's operations; and (3) the costs of manufacturing, distributing and marketing finished cement are non-mining costs in their entirety, since no portion of such costs is incurred for the benefit of the mining operations. Specifically, the court held in favor of the Government that the costs of pre-kiln additives, of packing and loading finished cement in bulk and in bags, the costs of bags, and the costs of warehousing were all non-mining costs in their entirety. The court further held that general administrative overhead was allocable between mining and non-mining in a manner in which both the Government and the taxpayer concurred. 7/

This was the first time a court of national or appellate jurisdiction had reasoned out and adopted a comprehensive set of

---

7/ The court also ruled that, on the facts of record, the taxpayer's so-called "cash discount" was a financial expense, and that such expense was allocable between mining and non-mining. In the instant case, as set forth above in our opening brief (pp. 39-42), it is clear on the record that, during the taxable years, taxpayer's so-called discount prices were its actual selling prices, set in competition with the other major producers in the same marketing area, and produced its actual gross income from sales of finished cement.

guidelines for application of the proportionate profits method by reference to the pre-kiln cutoff point of integrated cement producers. The Government subscribed to those guidelines then and does so still. As for the specific computation adopted by the court, this is unclear in some respects; but it is clear that, as to most items of non-mining costs, the court excluded from the computation both the costs and its proportionate part of the profits. As urged in our opening brief, we believe that the simplest and safest proportionate profits computation of depletable mining income will include every dollar of gross sales in the income figure to be allocated between mining and non-mining, and every dollar of the costs producing those sales in the cost fraction. However, the elimination from the computation of an item of non-mining costs together with an accurately-determined proportionate part of the profits, as in Standard Lime, has precisely the same result as if the costs were included in the denominator of the cost fraction and the income figure were left undiminished. Under either approach, an integrated producer's depletion base is only that portion of his gross sales which is produced by his mining costs.

Thereafter, on December 9, 1966, the Third Circuit decided Whitehall Cement Manufacturing Co. v. United States, 369 F. 2d 468. In this decision the court adopted the proportionate profits formula which includes every dollar of costs and every dollar of income,

expressed as: $\frac{\text{mining costs}}{\text{total costs}}$ x gross sales = gross income from mining. Rejecting the taxpayer's contention that costs of loading finished cement for shipment should be allocated between mining and non-mining, the court held that such costs were non-mining in their entirety because they bore no relation to pre-kiln "mining" as defined by statute. In support of this and other rulings, the court cited Standard Lime with approval. Also cited was this Court's decision in Riddell v. Victorville Lime Rock Co., 292 F. 2d 427, in support of the Third Circuit's ruling that costs of bags and bagging, like bulk loading costs, were (p. 474) "properly allocable to the non-mining operations". The court refused to exclude these costs from the computation together with the premium charged for bagged cement, scoring (p. 474) the "erroneous assumption that the packaging costs produced only the additional revenue derived from premiums". The court further held that the costs of additives were non-mining, although incurred prior to the cutoff point, citing this Court's 1964 ruling in Riddell v. California Portland Cement Co., 330 F. 2d 16, that the costs of purchasing and mining additives are not mining costs.

No other appellate court has yet considered specific issues with respect to the constructive mining income of an integrated cement producer, as computed under the proportionate profits method. The Tenth Circuit recognized generally in United States v.

Portland Cement Co. of Utah, 338 F. 2d 798, 802 (1964), that such a computation involves an allocation of profits between mining and non-mining in the proportion which mining costs bear to the total costs of the cement sold. More recently, on May 16, 1967, the Tenth Circuit held in United States v. Portland Cement Co. of Utah, 378 F. 2d 91, certiorari denied, 389 U.S. 975, that the District Court was required to employ the proportionate profits method in computing the taxpayer's depletion base, rather than the substitute materials method proposed by the taxpayer -- which was related to a hypothetical value of the mineral rather than constructive income from mining. 8/ More explicitly than in the earlier appeal in the same litigation, the Tenth Circuit characterized the proportionate profits method as one whereunder (p. 93) --

> the sale price of the product actually sold by the taxpayer (here, the sale price of cement) is allocated to mining according to the ratio that the costs of mining (here, the costs up through primary crushing) bear to the total costs (here, the costs of cement). This method assumes that each cost produces a proportionate part of the profit. 9/

8/ Portland Cement Company of Utah did not elect the pre-kiln cutoff point, and its depletion base is therefore the crushed stone.

9/ Specific applications of the method in determining the mining income of an integrated cement producer who elected the pre-kiln cutoff point are sub judice in the Tenth Circuit in United States v. Ideal Basic Industries, Inc., No. 9,571, on appeal from United States v. Ideal Cement Co., decided by the District Court for the District of Colorado on February 24, 1967 (18 A.F.T.R. 2d 6106). The appeal was argued before the Tenth Circuit on March 12, 1968.

In sum, the state of the law and legal climate is vastly different today from its state in 1962. Decisions of three appellate courts and the Court of Claims, spanning the years from 1964 through 1967, have clarified the nature of the proportionate profits method and have provided both general and specific guidelines for its application in computing the constructive mining income of integrated cement producers. At all points in common, these decisions are in basic accord and, as will appear below, they support or are consonant with the Government's contentions on appeal in the instant litigation. As will also appear, taxpayer errs in its assertion that there are other appellate decisions in point, and that these decisions support the taxpayer's contentions.

Without more, we submit that the Government is not foreclosed on the merits of the instant appeal by the doctrine of collateral estoppel.

II

THE DISTRICT COURT CLEARLY ERRED IN THE RULINGS FROM WHICH THE GOVERNMENT HAS APPEALED

In its opening brief the Government has already discussed in detail the rulings of the District Court from which it has appealed. In this brief our principal concern is with erroneous statements in taxpayer's opening brief with respect to applicable authorities.

A. The costs of handling and storing purchased or fully depleted additives prior to their addition to the kiln feed

In the prior litigation involving the instant taxpayer, this Court held in 1964 (330 F. 2d 16) the taxpayer's costs of purchasing and mining mineral additives were not includible in its mining costs for the purposes of the proportionate profits computation; since the purpose of the computation was to determine taxpayer's constructive income from mining calcium carbonate rock, that income could not be augmented by the costs of mining or, a fortiori, purchasing some other mineral.

The costs of handling and storing the additives separately, prior to their addition to the kiln feed, were not involved on that appeal.[10] But we submit that the rationale of this Court's ruling and the comparable rulings of the Court of Claims in Standard Lime and the Third Circuit in Whitehall require the same result. Costs incurred by taxpayer which are clearly and separately identifiable as relating to iron ore and quartzite are obviously not costs of mining calcium carbonate rock and should not augment taxpayer's depletion allowances thereon. Any other result, as this Court noted, would allow double depletion. As to the additives it mines, taxpayer takes

10/ Taxpayer concedes (Br. 16) that the Government is not collaterally estopped on this issue.

separate depletion; as to the additives it purchases, depletion is taken by the miner-vendor.

Taxpayer contends (Br. 66) that storing and handling its additives is only "incidental" to mining calcium carbonate rock. We submit that the storage and handling are no more "incidental" than the acquisition of the additives. Taxpayer invokes (Br. 64-65) Rev. Rul. 290, 1953-2 Cum. Bull. 41. But this ruling (revoked by Rev. Rul. 61-17, 1961-1 Cum. Bull. 193) did not involve purchased additives, nor did it hold that costs relating to a mined additive could be utilized to augment depletion allowances on calcium carbonate rock. It held only that mixing of calcium carbonates and shale by the miner thereof before crushing and grinding would be considered incidental to such process -- cautioning that the depletable mining income would have to be computed separately as to each mineral, notwithstanding the mixing. Thus, to the degree that this revoked ruling has any pertinence, it supports the Government's position on handling and storage.

B. The District Court should have included the costs of bags and bagging in the computation, as non-mining costs in their entirety, rather than excluding such costs together with the bag premium

The Third Circuit, in its 1966 decision in Whitehall Cement, held that the costs of bags and bagging, like bulk loading costs, were non-mining expenses in their entirety, citing

Standard Lime and this Court's decision in Riddell v. Victorville Lime Rock Co., supra. The court refused to exclude the costs of bags and bagging from the computation together with the premium charged for bagged cement, rejecting the assumption that there was any correlation between the two and emphasizing, generally, that every dollar of costs and income should go into the proportionate profits computation.

As it must, taxpayer concedes (Br. 21) that Whitehall Cement squarely supports the Government on the costs of bags and bagging. Nor was the Third Circuit making new law in holding that such costs and the costs of bulk loading, alike, are non-mining. Those rulings are in accord with the Court of Claims' rulings in Standard Lime that the costs of bulk loading and bags and bagging are non-mining expenses in their entirety, since no portion of such costs benefits the mining phase of the integrated cement producer's operations. (329 F. 2d, pp. 948-949.) Similarly, this Court's decision in Victorville Lime -- albeit it did not involve an integrated miner-manufacturer or application of the proportionate profits method -- affords general support for the characterization of bagging as a non-mining operation. And the Third Circuit's use of the taxpayer's actual gross sales as the income figure to be allocated, together with its emphasis on including all costs producing the sales in the cost fraction, is the approach more recently adopted by the Tenth

Circuit in United States v. Portland Cement Co. of Utah, 378 F. 2d 91, certiorari denied, 389 U.S. 975 (hereinafter referred to as "the fourth Utah appeal").

Taxpayer attacks Whitehall Cement on a variety of grounds, none of them sound. Taxpayer's assertion (Br. 62) that the Third Circuit was "not advised" as to the starting point in the proportionate profits computation borders on the frivolous; the court quoted and discussed in detail the regulatory definition of the proportionate profits method. Moreover, taxpayer is in error in its assertion that the "first marketable product" is the starting point under the regulation. The starting point is the "representative market * * * price" of the manufactured product, which is equated by the Third and Tenth Circuits with gross sales thereof. The object is to work back from this actual income figure to the taxpayer's constructive income from mining, and not to some hypothetical or constructive value of the mineral, as the Tenth Circuit held in the fourth Utah appeal. Thus, taxpayer is also in error in speaking (Br. 62) of "constructive values" of the kiln feed.

Principally, taxpayer endeavors to show that, on bags and bagging, Whitehall Cement is (Br. 21) "a minority view" and (Br. 62) contrary to "the great weight of authority". But the authorities cited by the taxpayer to support this contention (Br. 32-35) are not in point and hence do not derogate from the clear logic and ruling

in Whitehall Cement. The cases cited by taxpayer do not involve applications of the proportionate profits method to integrated producers; rather they involve determinations, with respect to unintegrated miners, as to their "commercially marketable * * * product" of mining processes. Most of these decisions (including Victorville) took into account the holding in Cannelton that a raw mineral is a commercially marketable product when it is suitable for industrial use and consumption, and can be shipped for such use, whether or not it can be sold at a profit. In Monolith the Supreme Court held that limestone has reached this state when it is crushed. Obviously, then, bagging was not a mining process; the "commercially marketable" product was simply the crude mineral resulting from mining processes, which were then defined by statute as "the ordinary treatment processes normally applied by mine owners or operators". Accordingly, Victorville and the other cases cited by taxpayer held that bagging the crude mineral was a post-mining operation, and the costs thereof could not be reflected in the taxpayer's depletion base.

So far as relevant, these rulings generally support the treatment of the costs of bags and bagging, in the proportionate profits computation, as non-mining costs in their entirety. But they are obviously not directly relevant since they have to do only with a statutory definition of mining processes, no longer in the Code, and a distinction thereunder between mining and post-mining operations.

The proportionate profits method does not call for a distinction in treatment between manufacturing and post-manufacturing costs; the distinction is between mining costs (the numerator of the cost fraction) and total costs (the denominator, which necessarily includes all manufacturing and post-manufacturing costs). The cost fraction controls the allocation of the integrated producer's gross sales between mining and non-mining income. Thus, in the case of a cement producer, every dollar of the costs producing his sales of finished cement must be taken into account on the premise that each dollar of costs earns its proportionate share of the profits.[11/]

11/ It may be noted, in closing the discussion on this point, that taxpayer relies in part (Br. 31, fn. 84) on quoted excerpts from testimony as "evidence" that its "first marketable product" was only cement in bulk. For example, taxpayer quotes Mr. Caldwell's admission (Pltf. Ex. 19, p. 118) of the obvious fact that bagging occurs after the production of bulk cement. However, Mr. Caldwell went on to testify that (p. 119) "the material sold in bags would not otherwise have been sold, except in bags and this probably should be considered as the first commercially marketable product for that material sold in bags". Similarly, Mr. Lintz, as quoted by taxpayer itself, testified that whether cement is sold at the bulk stage or beyond, it is "still cement. The bags have nothing to do with the first marketable product". (Br. 32, fn. 84.)

C. <u>The expenses incurred by taxpayer in selling its manufactured product are non-mining costs in their entirety</u>

In the Government's opening brief, we have already discussed (pp. 36-39) the expenses (largely salesmen's salaries) incurred by the taxpayer in promoting the sales of its manufactured product, finished cement. For the reasons there given, these selling expenses are non-mining in their entirety -- and should be so included in the proportionate profits computation -- since there is no basis in logic, and taxpayer has shown none, for allocating any part of these selling costs to "sales" of kiln feed. Of course, kiln feed is generally not sold commercially; integrated cement producers are deemed to sell it to themselves, under <u>Cannelton.</u> And, as taxpayer concedes (Br. 62), kiln feed is a "fungible product". There is no special quality in a particular producer's kiln feed which would indicate, as a basis for allocation, what the selling expenses of an unintegrated kiln feed producer might be. Accordingly, the selling expenses involved should be included in the denominator of the cost fraction in the proportionate profits computation.

Taxpayer invokes <u>Whitehall Cement</u> as authority for allocating selling expenses between mining and non-mining in the same ratio as general administrative overhead (Br. 21, 51-52, 61), but its reliance is misplaced. Only the District Court so held --

and taxpayer is in error in stating (Br. 52) that the Government did not appeal from that ruling. The Government duly perfected an appeal from that ruling; but the Third Circuit did not reach the issue because its rulings on the taxpayer's appeal were dispositive of the case.

Thus, the issue is one of first impression at the appellate level. We submit that the Government's position is logically sound and is supported by the rationales of Standard Lime, Whitehall Cement and the decision of the Tenth Circuit in the fourth Utah appeal. The Court of Claims did not hold, as taxpayer implies (Br. 53), that selling expenses are for the benefit of, and allocable in part to, the mining phase of a cement producer's operations. So far as relevant, Standard Lime holds only that the expenses of manufacturing and marketing the final product are not for the benefit of the mining operations, in any part, but are non-mining costs in their entirety.

D. The taxpayer's so-called discount prices were, on the record, its competitive selling prices and produced its actual gross sales

As shown in the Government's opening brief (pp. 39-42), the taxpayer's so-called discount prices -- whatever their original purpose and nature -- are revealed by the record in this litigation as competitive pricing devices which, during the taxable years, yielded the taxpayer's actual gross sales. The taxpayer's answering

arguments (Br. 56-59) are a circular play upon standard definitions of cash discounts and trade discounts. Quite obviously, if a discount is a genuine cash discount -- offered to induce prompt payment, and withdrawn if prompt payment is not forthcoming -- it must be treated as a cash discount. The question is one of fact. In Standard Lime the court found, on the record, that the taxpayer's discount was, in substance as well as in form, a cash discount. The similar finding in the prior litigation involving the instant taxpayer may have been warranted by the facts of record, as to earlier taxable years.

On the record in the instant litigation, the facts simply do not accord with such a finding. As detailed in the Government's opening brief, the so-called cash discount allowed by the taxpayer was precisely the same discount allowed by all of the major producers in taxpayer's marketing area, and was a competitive pricing device. While ostensibly allowed for prompt payment, it was not disallowed as to delinquent customers save in a miniscule percentage of sales. In short, taxpayer's so-called discount prices were its actual selling prices, and produced the gross sales which must be allocated between mining and non-mining income.

III

THE ALTERNATIVE COMPUTATION BELATEDLY PROPOSED BY THE TAXPAYER IN THE DISTRICT COURT IS WITHOUT MERIT

The decision of the District Court in the Ideal Cement Co. case, now pending on appeal in the Tenth Circuit *sub nom.* *Ideal Basic Industries, Inc.*, as noted above, allocated all post-manufacturing costs of loading, bagging, shipping, warehousing, etc., between mining and non-mining income. (18 A.F.T.R. 2d 6106.) That decision was entered by the District Court (Colo.) on February 24, 1967. The complaints in the instant litigation were filed, as noted in the jurisdictional statements, in 1965. The complaints did not envision the kind of allocations allowed in *Ideal Cement*; but, since they were so much more favorable to an integrated producer, the instant taxpayer belatedly proposed such allocations as to loading and shipping costs (including bagging) in its so-called "alternative computation". The District Court rejected them. (Nos. 22,397 and 22,397-A, I-R. 117; Nos. 22,398 and 22,398-A, I-R. 170.)

Toward the end of its brief, taxpayer urges (pp. 54-56) that its "alternative computation" be considered in the event that this Court does not affirm outright the decision below. We submit that the contention was untimely below, was and is wholly without merit, and was properly rejected by the District Court. The

taxpayer is not in a position to invoke the District Court decision in Ideal Cement -- even if it were correct, which it is not, and even if it were final, which it is not. In the instant litigation the parties have expressly stipulated that the "processes" applied by the taxpayer to produce cement and prepare it for marketing included storage, sacking and loading for shipment. (Nos. 22,397 and 22,397-A, I-R. 92; Nos. 22,398 and 22,398-A, I-R. 137.) The District Court's decision in Ideal Cement is bottomed upon the proposition that such activities are not such "processes".

A similar allocation advanced by the taxpayer in Whitehall Cement was rejected. Nor is there any basis whatever for the instant taxpayer's suggestion (Br. 56, fn. 142) that Standard Lime, at 329 F. 2d, p. 948, fn. 19, supports an approach even more favorable to the taxpayer. A mere reading of the cited page and footnote shows that this is not so. Whether labeled as "direct non-mining costs" or "non-allocable indirect costs", the result under the proportionate profits method is exactly the same so long as such costs are assumed to produce a proportionate part of the profits. In lieu of the cited footnote 19, we refer this Court to footnote 21 in the Standard Lime opinion, where the court said: "The cost of packing and loading bulk cement and the proportion of the total profits attributable to them must be taken out from the computation in the manner prescribed above".

The taxpayer attempts to draw an analogy between general selling expenses and packing or loading costs. (Br. 55.) However, the taxpayer overlooks the fact that the latter deal with specific quantities of finished cement and by no stretch of the imagination can be allocated back to pre-kiln mining activities. Nor would it be necessary for a non-integrated miner to sack his mineral product. Like selling, packing and loading expenses can be allocated back to mining only if there is some logical and rational basis for making the allocation. In the instant case, the evidence demonstrates that all of such costs relate wholly and entirely to the finished end product rather than to the intermediate mineral product.

Respectfully submitted,

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
GRANT W. WIPRUD,
ROBERT LIVINGSTON,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

Of Counsel:

WM. MATTHEW BYRNE, JR.,
United States Attorney.

LOYAL E. KEIR,
Assistant United States Attorney.

MAY, 1968.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: 6th day of May, 1968.

Loyal E. Keir

Assistant United States Attorney.